

Fundraising slowdown and the rise of private credit

[Ben Jones](#) and [Francesca Raffa](#) reflect on the annual Markets Group Forum in New York in May, and explore the two hottest topics being discussed by your peers right now - the slowdown in fundraising and the rapid acceleration of the private credit market.

Both topics were very much front of mind for delegates in New York and, although they are two very different subjects, the fundraising decline and the private credit rise are tied together by the same thread - rising inflation and a global hike in interest rates.

In a bid to stem rampant inflation, central banks across the world have been busy raising interest rates. The US Federal Reserve increased rates by 25 basis points in May, the tenth consecutive rise since March 2022. The Fed paused further increases in June but central bank chair Jerome Powell has suggested there will be another two rises to come before the end of this year. At the same time, the European Central Bank hiked rates by 0.25 percentage points to 3.25 per cent in May, the seventh increase in a row.

Inflation has persisted, however, and though many had hoped that the rate hiking cycle was coming to an end, those in the private equity sphere are bracing themselves for further increases. ECB president Christine Lagarde summed it up as she announced the latest rise: "We are not pausing...we have more ground to cover."

Fundraising

This has had a significant impact on both fundraising and private credit. Interest rate rises are never great for fundraising, with private equity firms now having to fight for capital with fixed income and credit instruments, which have become increasingly attractive as rates have risen.

This, coupled with what is known as the 'denominator effect', is causing a perfect

storm for fundraising. In essence investors are also having to reduce their private equity holdings because the value of their public holdings has fallen, creating the need to rebalance portfolios so that previous asset allocation targets are met.

And the numbers play this out. According to figures from S&P, the amount of private equity funds that closed in 2022 slumped by more than 45 per cent compared to the previous 12 months, while the number of funds launched fell 67 per cent.

Fundraising is also taking much longer. What we learnt from speaking to delegates in New York is that private equity managers who were previously successful in raising large sums of money and are now sitting on a lot of dry powder, or uninvested capital, plan to invest that money over the next two years rather than going back out to the market and asking for more.

Firms not in a position to do that and who didn't plan for the current interest rate environment are in for a much rougher ride but, as always, it will be performance that really matters.

Private credit

While other areas of the market have struggled, private credit has boomed over the last 20 years, with many investors at the conference referring to the present time as a 'golden moment' for the asset class.

During the global financial crisis of 2008, banks were forced to reduce their lending to smaller, riskier borrowers, creating something of a funding gap. Non-banking private lenders would fill the void, effectively launching the private credit market we know it today. The failure of banks in 2008 created instability in the market which has impacted the financial sector ever since, and this is still impacting fund raising today.

The result has been a surge in assets, with private credit growing from around \$40bn in December 2000 to more than \$300bn by December 2010, according to figures from data provider Preqin. By the beginning of last year, assets had broken through the \$1tn mark.

It's a sector that excited delegates at the conference and created a lot of chatter as private credit is a floating-rate asset class that offers some protection from

inflation. Unlike many other asset classes, rising interest rates and spiking inflation can be beneficial to investors in private credit, which in turn creates strategic opportunities for fund managers wanting to raise assets.

There are caveats, however. Rising rates require the portfolio companies within the private credit funds to stump up more cash to service higher debt interest payments and so there is a concern that investors in private credit funds could face higher default rates and, eventually, losses as a result.

The key then for managers will be to create diversified funds to reduce concentration risk, picking companies within highly defensive sectors such as software and technology, food and beverage, and healthcare. Good companies with strong track records which can generate cashflow going forwards.

Regardless, there is no doubting the current success of private credit and the whole of the private equity market will be watching on to see what comes next.

What our discussions in New York showed was that, whatever the direction of inflation and interest rates, opportunities continue to exist for managers who are nimble enough to act as these opportunities arise. Markets are bullish now in the expectation of further market turmoil, with cash flow generation the current focus in terms of deal selection and investor appetite. The primary market is the place to be, while M&A activity will continue to drive capital demand.

Agree? Please reach out to [Ben](#) or [Francesca](#) if you'd like to discuss anything we've explored in this article in greater depth.